

JPMORGAN CHASE & CO.

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Via Electronic Mail

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Amendments to the Regulatory Capital, Capital Plan and Stress Test Rules (Docket No. R-1603; RIN 7100-AF 02)

Ladies and Gentlemen:

JPMorgan Chase & Co. (JPMC) appreciates the opportunity to comment on the proposal by the Board of Governors of the Federal Reserve Board System (FRB) to establish a stress buffer framework that would create a single, integrated set of capital requirements by combining the supervisory stress test results of the Comprehensive Capital Analysis and Review (CCAR) assessment and those required under and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act Stress Test) with current point-in-time capital requirements. JPMC supports the views represented in the comments submitted by the Joint Associations,¹ the American Bankers Association, and the Financial Services Forum, but wishes to provide a specific proposal related to the further application of the Global Systemically Important Bank Holding Companies (GSIB) surcharge as a post-stress requirement within the context of this Proposal. **JPMC believes the FRB should simplify the U.S. GSIB framework by moving to a single systemic indicator calculation based on a recalibrated Method 2 approach that eliminates U.S. gold plating and accounts for significant post-crisis reforms, economic growth, and the comparatively more stringent U.S. regulatory framework, particularly as it relates to the U.S. capital conservation buffer (CCB) requirements under the Proposal.**

JPMC appreciates that during the previous financial crisis, the failures and impairments of a number of large, globally active financial institutions sent shocks through the financial system, which, in turn, harmed the real economy. In response, international standard setters and national regulators appropriately implemented a series of reforms to improve the resilience of banks and the banking system. FRB Vice Chairman Randal Quarles noted the progress of the U.S. banking system since the crisis when he stated that “we have spent the past decade building out and standing up the post-crisis

¹ Comment letter submitted jointly by The Clearing House Association L.L.C., the Securities Industry and Financial Markets Association, and the Financial Services Roundtable

regulatory regime, and as a result we have made critical gains. The financial system is undoubtedly stronger and safer. We have robust capital and liquidity levels, an effective stress testing regime, and improved resolvability of our largest firms.”²

However, by the FRB’s own estimates, and as empirically evidenced by the results of the 2018 Dodd-Frank Act Stress Test,³ the Proposal will result in a further increase to GSIB capital requirements⁴ and will make such requirements significantly more volatile from year to year. Accordingly, it is essential that the FRB conduct a thorough review of the financial impact of the Proposal in order to avoid a reduction of resources available to support U.S. economic growth and capital markets. This should include an assessment of the entire U.S. regulatory framework to ensure that existing post-crisis reforms – many of which are implemented in a more stringent manner compared to jurisdictions other than the United States – work coherently with one another so as to avoid overlap and duplication throughout the framework, inclusive of this Proposal. While we recognize that a comprehensive assessment of the U.S. regulatory framework will take significant time, we strongly urge the FRB to propose an immediate recalibration of the U.S. GSIB surcharge prior to the first publication of firms’ capital buffer requirements following the finalization of the Proposal. The direct contribution of the GSIB surcharge to capital buffer requirements demands that the surcharge itself be appropriately calibrated to reflect the benefits of *all* post-crisis reforms, especially those that have been enacted subsequent to the finalization of the U.S. GSIB framework in 2015.

When the Basel Committee on Banking Supervision (BCBS) finalized its assessment methodology in 2013,⁵ it noted that the GSIB surcharge is primarily intended to ensure that the expected impact arising from the failure of a GSIB is equalized with that of a large non-GSIB. The FRB used the same “expected impact” framework in finalizing its GSIB framework in 2015,⁶ which included the Method 2 systemic indicator calculation methodology that was ultimately calibrated such that it generally results in a higher surcharge than under the Method 1 calculation methodology imported from international BCBS standard. However, since the finalization of both the international and U.S. GSIB frameworks, U.S. GSIBs have successfully implemented a number of post-crisis reforms that (i) reduce the probability of a GSIBs default relative to non-GSIBs,⁷ and (ii) reduce the impact on the financial system and real economy in the event of a GSIB’s failure.⁸ In particular, we would highlight the significant contributions of the steps taken by U.S. GSIBs in connection the requirement under section 165(d) of the Dodd-Frank Act⁹ to develop credible resolution plans, including enhancements to capital, liquidity, governance and

² <https://www.federalreserve.gov/newsevents/speech/files/quarles20180226b.pdf>, Randal K. Quarles, February 26, 2018.

³ <https://www.federalreserve.gov/publications/files/2018-dfast-methodology-results-20180621.pdf>.

⁴ GSIB common equity tier 1 capital requirements will increase by approximately \$10 billion to \$50 billion in aggregate, based on 2015 and 2017 data, as described in the Proposal. <https://www.gpo.gov/fdsys/pkg/FR-2018-04-25/pdf/2018-08006.pdf>.

⁵ <http://www.bis.org/publ/bcbs255.htm>.

⁶ <https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf>.

⁷ A number of U.S. post-crisis reforms reduce the probability of default for U.S. GSIBs relative to non-GSIBs as they either: (i) only apply to GSIBs, such as the enhanced supplementary leverage ratio (eSLR); or (ii) are meaningfully more stringent for GSIBs, such as the enhancements to stress testing, the liquidity coverage ratio (LCR) and single counterparty credit limits.

⁸ These include the requirement under section 165(d) of the Dodd-Frank Act to develop credible resolution plans, total loss absorbing capacity (TLAC) and related clean holding company requirements, the prohibition on entering into certain financial contracts that may impede resolvability, and increased central clearing and margin requirements for derivatives.

⁹ <https://www.fdic.gov/news/news/press/2016/pr16031b.pdf>.

legal entity rationalizations that have materially reduced the systemic impact of the failure of a GSIB, including preparation for a more orderly and expeditious resolution post-failure. These developments, in combination with the wider promulgation of the GSIB surcharge both as part of a post-stress minimum through the Proposal and more broadly throughout the capital rules, make immediate reassessment and recalibration of the GSIB framework an absolute necessity.

JPMC believes that the Method 1 systemic indicator calculation, as well as the international standard developed by the BCBS on which the Method 1 methodology is based, have a number of fundamental flaws, including the following:

1. The Method 1 surcharge measures each GSIB's systemic indicator score relative to the systemic indicator score of the 75 largest global banking institutions. This undermines the incentive and practical ability of GSIBs to improve or control their "measured" systemic profile, and ultimately to engage in effective capital planning. Furthermore, this relative measure of systemic risk results in changes to the score that are not related to underlying changes in systemic risk. For example, if all GSIBs achieve a significant but equal reduction in their systemic indicator scores, there will be no change in any firm's GSIB surcharge, despite the obvious decrease in risk posed by GSIBs to the financial system. Additionally, the inclusion of a firm's issued common equity on a fair value basis in the interconnectedness indicators results in relative changes in share prices between GSIBs impacting the Method 1 score even though it is completely beyond the control of any one firm's management.
2. Systemic indicators are required to be converted to euros using a spot rate, exposing U.S. GSIB scores to significant volatility from changes in foreign exchange rates, which is unrelated to systemic risk. For example, the 2016 Method 1 scores of U.S. GSIBs increased up to 12%, solely as a result of the appreciation of the U.S. dollar vis-a-vis the euro over the assessment period.¹⁰ In particular, if the euro to U.S. dollar had not changed during 2016, none of the U.S. GSIBs would have moved to a higher risk bucket under the Method 1 score.
3. As acknowledged by both the BCBS and the FRB, there is a cap on the substitutability indicator in Method 1 because "the substitutability category had a greater-than-intended impact on the assessment of systemic importance for certain banks that are dominant in the provision of asset custody, payment systems and underwriting."¹¹ Although the BCBS noted that future "revisions to the methodology may allow [the cap] to be removed at that time,"¹² the removal of the cap was recently proposed by the BCBS without any corresponding recalibration that would be a prerequisite to prevent such an outsized impact. Although it has not yet been implemented, this

¹⁰ <https://www.theclearinghouse.org/advocacy/articles/2016/11/22-g-sib-assessment-critique>.

¹¹ <https://www.gpo.gov/fdsys/pkg/FR-2015-08-14/pdf/2015-18702.pdf>. The BCBS similarly acknowledged this flaw with the substitutability category. <http://www.bis.org/publ/bcbs255.htm>.

¹² <http://www.bis.org/publ/bcbs255.htm>

proposed change negatively impacts only four U.S. institutions,¹³ of which JPMC is one, and is inconsistent with the FRB's decision to eliminate the substitutability indicator from Method 2.

JPMC commends the FRB for the work undertaken in the development of the Method 2 systemic indicator methodology, which builds on many of the conceptual principles of Method 1, but addresses a number of its conceptual flaws including elimination of the relative measure and replacement of the substitutability indicator with a measure of short-term wholesale funding. The enhanced Method 2 calculation provides U.S. GSIBs greater confidence in capital planning over time. However, JPMC disagrees with the "gold-plated" calibration of the Method 2 calculation, not only in the context of the successful implementation of post-crisis reforms by U.S. GSIBs as set out above, but also because it creates an un-level playing field by requiring U.S. GSIBs to hold more capital than their international peers. As such, we encourage the FRB to recalibrate Method 2 on a timely basis to address the following:

1. In the calibration framework used by the FRB in finalizing Method 2, the choice of the hypothetical reference bank is the key input, as each firm's GSIB surcharge is set based on its systemic indicator score relative to the reference bank indicator score. This reference bank must reflect an appropriate level of expected systemic loss for a GSIB and not be so large that its failure would cause an out-sized risk to the financial system. The FRB weighed several options in its 2015 paper and ultimately selected a reference bank profile that resulted in the higher, gold-plated calibration of Method 2,¹⁴ which we believe should now be recalibrated.

The recalibration should eliminate this gold-plating to reflect the successful implementation by U.S. GSIBs of post-crisis reforms that have collectively reduced their probability of failure and loss to the financial system and real economy given a GSIB's default, including but not limited to: (i) more stringent and severe stress testing (specifically the Global Market Shock and Largest Counterparty Default components), (ii) heightened standards for resolution planning, and (iii) TLAC requirements.¹⁵

2. Method 2 is calibrated using fixed coefficients, which are a conceptual strength of this approach as they facilitate efficient capital planning and management. However, as acknowledged by the FRB, U.S. GSIBs' Method 2 scores may inflate over time due to economic growth that is unrelated to an actual increase in systemic risk. As such, the FRB has specifically noted that "to ensure that changes in economic growth do not unduly affect firms' systemic risk scores the Board will periodically review the coefficients and make adjustments as appropriate."¹⁶ Since

¹³ "The Committee has assessed the implications of removing the cap on the substitutability category. Its findings suggest that the removal of the cap affects the scores of four banks based on the end-2015 scores"

<https://www.bis.org/bcbs/publ/d402.pdf>.

¹⁴ <https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-methodology-paper-20150720.pdf>.

¹⁵ <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403293>, FRB Vice Chairman Randal Quarles stated "the reason for the GSIB surcharge is precisely our assessment of the heightened consequence of their default" and noted further that "'it's generally accepted that [the living will process] has resulted in improvement in resolvability of the firms and that means the consequence of the firm [failing] is less."

¹⁶ <https://www.gpo.gov/fdsys/pkg/FR-2015-08-14/pdf/2015-18702.pdf>.

initial calibration of the coefficients,¹⁷ the U.S. economy has grown between 11-16%¹⁸ and systemic footprint of U.S. GSIBs has changed relative to their peers. Over the same observation period, the fair value of JPMC's common equity value increased 58%,¹⁹ resulting in a 12 point increase to JPMC's Method 2 GSIB score. Each of these effects should be given consideration in the recommended recalibration of Method 2 to ensure that the GSIB surcharge does not unduly hinder lending and capital markets activities and, therefore, broader economic growth.

3. The 50 basis point surcharge "buckets" in Method 2 should be replaced with a more graduated surcharge scale. The current construction creates a cliff effect when moving up a bucket that could lead to artificial restrictions on business activities, especially when combined with the likely volatility in capital requirements resulting from implementation of the stress capital buffer under the Proposal.

JPMC believes that the FRB should complete the process that it started when it developed the Method 2 calculation and move to a GSIB surcharge that uses a recalibrated Method 2 calculation as the single methodology for the systemic indicator score. This would promote further simplicity of the regulatory framework, and result in a conceptually superior GSIB surcharge methodology that is founded on the principles established by the BCBS, while appropriately correcting flaws inherent in the international standard. This would also recognize important differences in the U.S. regulatory framework for GSIBs, which is vital to ensuring that U.S. GSIBs are placed on a truly level playing field with non-U.S. peers. To allow firms to take all necessary capital actions in good time, a recalibrated GSIB calculation methodology should become effective before, or simultaneously with, the first publication of firms' capital buffer requirements following the finalization of the Proposal, and certainly no later than the effective date of such first capital buffer requirement.

Additionally, JPMC would strongly disagree with any alternative approach that would result in the temporary or permanent reliance on the flawed Method 1 methodology, or the international standards on which it is based, in order to address the fact that capital requirements under the Proposal may be higher than warranted, as this would ultimately result in a conceptually weaker approach that would disregard the substantial progress the FRB made in 2015 in developing the Method 2 methodology.

With regard to moving to a single GSIB calculation based on a recalibrated Method 2, JPMC believes that it is essential for both national regulators and international standard setters to immediately move to an "outcomes-based approach" when determining consistency with international standards established by the BCBS. Consistency with such standards should not be determined by

¹⁷ As noted by the FRB when adopting its GSIB surcharge rule, the fixed approach used in Method 2 employs constants, described immediately below, that are based on the average of the aggregate global indicator amounts for each indicator for year-end 2012 to 2013. <https://www.gpo.gov/fdsys/pkg/FR-2015-08-14/pdf/2015-18702.pdf>.

¹⁸ Based on FRED U.S. GDP data, from the fourth quarter of 2014 to the fourth quarter of 2017 U.S. GDP increased by 11.4% and by 16.2% from the fourth quarter of 2013 to the fourth quarter of 2017.

¹⁹ Based on reported Form FR Y-15, Schedule B, Common Equity, JPMC December 2014 and December 2017.

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whether there has been a verbatim adoption of BCBS' international standards as a matter of U.S. law, but rather should consider and account for the robustness and stringency of the entire U.S. regulatory landscape – inclusive of its capital, liquidity, resolution and stress testing. This complete view is especially relevant in light of the enhanced role that stress testing assessment will now play in determining point-in-time capital requirements for U.S. banking organizations, coupled with the GSIB surcharge now intended to serve as a new post-stress minimum capital buffer requirement. Moreover, as evidenced by the FRB's own impact assessment and the results of the 2018 Dodd-Frank Act Stress Test, certain aspects of the Proposal – e.g., the replacement of the current CCB requirement, which is based on the BCBS international standard, with a firm's peak to trough stressed losses – will result in U.S. GSIBs holding a CCB in excess of the BCBS minimum of 2.5%. Therefore, the move to a single, recalibrated Method 2 that accounts for the finalization of the TLAC requirements, enhanced resolution planning requirements, and the comparatively more stringent U.S. regulatory framework, particularly as it relates to U.S. CCB requirements under the Proposal, should not be viewed as a deviation from international standards, but rather a simplification and warranted reassessment of the GSIB surcharge as it relates to the other regulations that comprise the comparatively more rigorous regulatory framework in the United States.

JPMC appreciates the opportunity to provide these comments. We would be pleased to provide any further information or respond to any questions.

Respectfully submitted,



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